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SUBJECT: ANC Document Presents Controversial Economic Policy Changes

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11. (SBU) Summary. An ANC document proposes controversial policy changes to address poverty, unemployment and income inequality. Key suggestions include measures to promote a more competitive currency and liberalize labor market regulation. President Mbeki is likely behind the discussion document, apparently growing increasingly concerned that South Africa's moderate growth over the last decade has not dented unemployment. Achieving the policy changes, especially in the labor market, will be difficult: key ANC allies are strongly opposed. We would expect lively debate on the policy suggestions when the ANC General Council meets later this month, but fallout from the firing of South African Vice President Jacob Zuma, implicated in a fraud conviction; and the emerging "oilgate" ANC funding scandal could well dominate the proceedings. End Summary.

12. (U) In advance of its June 29-July 3 National General Council meeting, the ANC circulated a discussion document entitled "Development and Underdevelopment - Learning from Experience to Overcome the Two Economy Divide." The document proposes policy revisions to address South Africa's key economic challenges. The General Council will provide guidance to the ANC's Executive Committee as it prepares for the organization's 2007 National Conference.

#### Changes Needed to Address Poverty, Unemployment -----

13. (U) The document states that while ANC economic policy has achieved important results over the decade of majority rule, including macroeconomic stability, lower government debt and inflation, and strong manufactured export growth; growth has not been sufficient. Challenges remain: high unemployment, especially among youth, and job losses in the formal sector; low savings and investment levels; and poverty and income inequities based largely on race, gender and region. To address these, the ANC should modify some of its microeconomic policies to ensure the integration of South Africa's "First" and "Second Economies."

14. (U) The paper states, however, that government alone cannot resolve these challenges and argues that government interventions should set the preconditions for market-led growth. Interventions must focus on investment to create jobs; investment in infrastructure that contributes to development; support for small and medium sized enterprises; and investment in education, training and health. The paper, for example, rejects welfare grants and increases in the social wage to solve the problems of unemployment and poverty.

15. (U) The policy document recommends that South Africa pursue a strategy to raise the level of investment and economic activity while reforming the labor market so that more labor is absorbed and the benefits of growth are spread more evenly. Elements of this strategy entail reducing the cost of capital and supporting a more competitive currency, while allowing labor demand to expand through more flexible labor market policies.

#### Lower Capital Costs, Competitive Currency -----

16. (U) The ANC paper cautions that a policy to reduce the cost of capital should not be based on artificial reductions of real interest rates. Lower

real interest rates must come from prudent fiscal policy, more efficient use of capital in state-owned enterprises (reftel A) and a more competitive unit labor cost. The paper also suggests that government pursue policies that allow for a more competitive exchange rate without abandoning the inflation-targeting model. It could, for example, accumulate reserves more aggressively and liberalize further foreign exchange markets, approaches long advocated by private sector economists. Both National Treasury and Reserve Bank officials subsequently made clear that South Africa would not intervene in the market to influence the exchange rate.

17. (U) Interestingly, the policy document suggests that South Africa could approach international financial institutions for assistance, something it has heretofore not done. It asserts that reducing the cost of capital in the "Second Economy" can only be achieved by the state carrying the cost of the price reduction, which adds to fiscal pressure. The magnitude of this burden, however, could be limited by seeking soft loans from international multilateral institutions. Finance Minister Manuel subsequently suggested that the topic could be on the agenda for discussion when new World Bank President Wolfowitz visits South Africa this weekend. In the past, the Congress of South African Trade Unions (COSATU) and the South African Communist Party (SACP) have staunchly opposed such borrowing because of "political conditions."

18. (SBU) The ANC document also points out that the capital requirements for financing black economic empowerment (BEE) deals do not necessarily raise the productive investment levels in the domestic economy and, therefore, represent a drain on scarce capital assets. This, the paper notes, is an example of where policy decisions sometimes contradict each other resulting in the failure to meet important objectives. The statement, however, does not portend major changes in BEE policy but rather closer attention to the financial structuring of BEE deals.

#### Liberalize Labor Markets

19. (U) Most controversially, the ANC paper suggests that small adjustments in labor market regulation could produce substantial returns for job creation. The government should consider changes to the present bargaining arrangements to limit their effects on parties outside the agreement. It should also consider accommodating some flexibility in its labor laws to allow younger workers to be regulated under a more flexible regime. It could waive the minimum wage and other collective bargaining arrangements and make it easier to dismiss non-performers. Government could apply labor laws more flexibly in its industrial development zones or in sectors such as tourism, textiles and clothing, household and childcare and agriculture. The paper also suggests an increase in the size of companies that must comply with certain aspects of the labor legislation from 50 to 200 and a reduction in the tax compliance burden to stimulate small business development.

10. (SBU) Comment. Despite sprinklings of "leftist" rhetoric, the ANC document proposes sound initiatives, long advocated by independent economists and organizations such as the IMF, to address the country's key economic challenges. It fails, however, to address two important economic issues: South Africa's inability to attract significant levels of foreign direct investment and the economic effects of HIV/AIDS. Barclays Bank's purchase of ABSA bank and General Motor's re-purchase last year of its South African facilities are positive signals for investor confidence but do not represent a trend. Despite wide discussion in the public and in private industry circles, the effect of HIV/AIDS on the economy is apparently still considered too sensitive for the government to address as an economic issue.

11. (SBU) President Mbeki is likely behind the presentation of the discussion document. Last year, he initiated a large public works program to mop up the jobless, and following a visit last week to Chile, he will send a team there to study how Chile reduced by more than one-half the portion of the population living below the poverty line in ten years, exactly what the ANC has been unable to do. These actions suggest strongly that Mbeki is concerned that South Africa's moderate growth over the last decade has not dented unemployment.

¶12. (SBU) Unfortunately, as the policy paper correctly notes, achieving the suggested policy changes, especially in labor regulation, will not be easy. COSATU, the SACP and the ANC Youth League have all come out strongly against any liberalization of labor laws. Both COSATU and the SACP have, however, endorsed calls for a more competitive currency to save jobs in the mining and clothing/apparel industries. In fact, the paper, comments by senior central bank officials and recent dollar strength have prompted a depreciation of the rand to its lowest level this year (R6.7/\$).

¶13. (SBU) Under other circumstances, we would expect lively debate on the policy suggestions during the ANC conference. However, fallout from the firing of South African Vice President Jacob Zuma, implicated in the fraud conviction of Schabir Shaik (reftel B); and the emerging "oilgate" ANC funding scandal could well dominate the proceedings. Frazer